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No. 82-500

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE SOUTHLAND CORPORATION, *et al.*,
Appellants,

v.

RICHARD D. KEATING, *et al.*,
Appellees.

On Appeal from the Supreme Court of California

APPELLANTS' OPPOSITION TO MOTION TO DISMISS

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Appellants The Southland Corporation, *et al.* ("Southland") oppose appellees' Motion to Dismiss for the reasons set forth below.

A. The Court Has Jurisdiction Over This Case

1. *The Class Arbitration Issue Was Raised and Litigated in the Court Below*

Appellees argue that Southland failed to raise in the court below the question whether arbitration under the Federal Arbitration Act would be unlawfully impaired by judicially imposed class action procedures. (Motion to Dismiss at 5-6.) Appellees' contention is without merit.

In Southland's petition for hearing in the California Supreme Court, it framed the issue as "[w]hether a court may enter an order compelling a private commercial arbitration governed by the Federal Arbitration Act and the rules of the American Arbitration Association to

proceed as a class action . . . ." (Pet. for Hearing at 2.) In the body of its brief, Southland then argued: that "[u]nder both federal and California law" (*id.* at 6) arbitration is highly favored; that arbitration is intended to operate outside the judicial system; that a class action arbitration would require intimate judicial involvement; and that class action procedures would effectively eliminate the benefits of arbitration as a quick, inexpensive, informal alternative to judicial proceedings. Southland further argued that a class action arbitration would deny absent class members due process of law in violation of the U.S. Constitution unless courts closely supervised the arbitrator's conduct at every stage of the litigation. (*Id.* at 10-22.) Approximately sixty federal court decisions were cited in Southland's brief in support of these propositions.

It is of no moment that Southland additionally relied upon *state* court decisions from California and elsewhere. Quite plainly, the goals and procedures of arbitration would be equally affected by class action procedures regardless of whether a state arbitration statute, as opposed to the Federal Arbitration Act, were applicable. Moreover, since Southland and the appellee-franchisees had already *agreed* in the lower courts that the Federal Arbitration Act governed this case, it was unnecessary for Southland to argue at length that the policies of the federal statute—as opposed to the state arbitration law—would be affected by a class action.[1] Precedents from

[1] In the California Court of Appeal, the franchisee-plaintiffs noted that they "have not challenged Southland's contention that . . . the Federal Arbitration Act is applicable." (Petitioners' Supp. Mem. in re Arbitration in a Class Action, July 10, 1979, at 7.) The Court of Appeal accordingly had no difficulty in concluding that the federal act governed the case. (J.S. App. at 52a-53a.) Thus, in Southland's petition for hearing to the California Supreme Court, it was only necessary to note briefly that "[t]he instant cases are governed by the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, since the dispute involves interstate commerce." (Pet. for Hearing at 6 n.6.)

both federal and state courts were thus germane to the issues presented before the California court.[2] Likewise, the California Supreme Court found no need to dwell upon this point in its decision: It simply noted that the Federal Arbitration Act was applicable and was to be taken into account (J.S. App. 4a-5a), and then proceeded to address the questions whether such an arbitration would be unduly impaired by class action procedures and whether a class action in this context would deny class members due process of law.

2. *28 U.S.C. § 1257(2) Is Satisfied*

Appellees contend that one of the two issues raised by Southland's Jurisdictional Statement (the class arbitration question) must be reviewed under this Court's certiorari jurisdiction, rather than by appeal under 28 U.S.C. § 1257(2). (Motion to Dismiss at 8.) This argument ignores the rule that once the Court has appellate jurisdiction over one issue, it "also take[s] jurisdiction over any aspects of the case which would otherwise fall solely within [its] certiorari jurisdiction." *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469, 487 n.14 (1975). Since § 1257(2) clearly applies to at least one of the issues presented here (*i.e.*, the question whether the anti-arbitration policy in the California Franchise Investment Law is pre-

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[2] Appellees recognized in the courts below that it was appropriate to rely upon state court decisions even though the class arbitration issue arose under the Federal Arbitration Act. For example, in one of their briefs they stated:

> We are willing to accept the proposition that if there were a conflict between federal and state law, the federal law would control. Actually, we have been unable to discover any substantive difference between the federal act and the California statute, at least none that has any bearing on this case.

(Petitioners' Supp. Mem. in re Arbitration in a Class Action, July 10, 1979, at 7.)

empted by the Federal Arbitration Act), the Court has appellate jurisdiction over the entire case.[3]

3. *The Decision of the California Supreme Court Is an Appealable Final Judgment or Decree*

Appellees are incorrect when they assert that the California Supreme Court's decision on the class arbitration issue is not an appealable final judgment or decree. It is true, of course, that the dispute between the parties has not been finally resolved. However, the California court's decree clearly falls within a well-recognized category of cases in which this Court treats a decision as a final judgment even though additional proceedings are anticipated in the state courts. The case at bar is within the fourth category of appealable final judgments set forth in *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 482-83, namely, situations where (i) the federal issue has been finally decided in the state courts, (ii) reversal of the state court decision would be preclusive of further litigation on the relevant cause of action rather than merely controlling the nature of the state proceedings, and (iii) refusal to review immediately the state court decision might seriously erode federal policy.

First, the California Supreme Court has finally and conclusively upheld a state law restricting arbitration and has also ruled that judicial class action procedures are available in the arbitration context. Therefore, unlike the situation in *Flynt* v. *Ohio*, 451 U.S. 619, 621 (1981),

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[3] Moreover, § 1257(2) is independently satisfied with respect to the class arbitration issue. Although the class arbitration issue does not involve a state "statute," it does challenge California's class action rules. When, as here, court rules have a substantive, adverse impact on a federal substantive right, this Court has jurisdiction under § 1257(2). *Cf. In re Griffiths*, 413 U.S. 717 (1973); *Mayer* v. *City of Chicago*, 404 U.S. 189 (1971). In any event, the substantial issues presented in Southland's Jurisdictional Statement warrant review under the Court's certiorari jurisdiction. *See* 28 U.S.C. § 2103 (1976).

no other federal issues remain to be resolved and there is "no probability of piecemeal review with respect to federal issues."

Second, reversal by this Court would preclude further judicial litigation of the parties' dispute. Southland and the franchisee-complainants would quickly proceed to arbitration and the court proceedings would be at an end, as there would be no need for judicial supervision of any class action proceedings.

Third, a refusal to review immediately the California Supreme Court's decision "might seriously erode federal policy." *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 483. Appellees suggest in their Motion to Dismiss that no impairment of federal rights will occur unless the trial court ultimately certifies this case as a class action. (Motion to Dismiss at 6-7.) This misses the point. The decision of the court below permits a party to an arbitration agreement to file a judicial action, thereby invoking the formalities, procedures and delays inherent in court proceedings. It authorizes, at the very least, the filing of complaints, answers, motions of various kinds, discovery on the class action issue, briefing to the court, and a judicial decision on the class issue—a process that would consume many months. Thus, regardless of whether the court eventually certified the case as a class action at the end of this process, the parties would have been forced to run the gauntlet of expensive and time-consuming procedures in direct contradiction to "the unmistakably clear congressional purpose [in the Federal Arbitration Act] that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts." *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967). Moreover, as in *Cox*, even if Southland prevails in the further proceedings, "there would remain in effect the unreviewed decision of the State Supreme Court" that class action arbitrations may go forward despite the Federal Arbitration Act and due process considerations. 420 U.S. at 485.

Thus, the resolution of the questions now before the Court cannot "await final judgment without any adverse effect on important federal interests." *Flynt* v. *Ohio*, 451 U.S. at 622.

This case is also similar to the situation faced by the Court in *Mercantile National Bank* v. *Langdeau*, 371 U.S. 555 (1963), in which it reviewed an order that concerned the appropriate forum for further proceedings. As in *Langdeau*, it would serve "the policy underlying the requirement of finality in 28 U.S.C. § 1257 to determine now in which [forum] appellants may [proceed] rather than to subject them . . . to long and complex litigation which may be for naught if consideration of the preliminary question . . . is postponed until the conclusion of the proceedings." *Id.* at 558.[4]

Applying the "pragmatic approach" by which this Court determines finality for purposes of review,[5] it is clear that the judgment of the California Supreme Court is presently appealable to this Court.

B. The Questions Are Substantial

1. *State Courts Are Not Free to Encumber Private, Interstate Arbitrations with Judicial Class Action Procedures*

Appellees argue in their Motion to Dismiss that the Federal Arbitration Act is not applicable "in any respect" when proceedings relating to arbitration are filed in a

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[4] The present case is also similar in this respect to *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541, 546 (1949), in which the Court reviewed a collateral order regarding an issue which was separable from, and independent of, the merits and where, if review were postponed until the end of the litigation, it would be "too late effectively to review the present order, and the rights conferred by the statute . . . [would be] lost, probably irreparably." *Accord, Firestone Tire & Rubber Co.* v. *Risjord*, 449 U.S. 368, 376-77 (1981). *See also Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 481-82 & n.10.

[5] *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 486-87, 478 n.7.

state court. (Motion to Dismiss at 10-14.) This position ignores the critical distinction between matters of substance and procedure.

The Federal Arbitration Act contains both substantive and procedural provisions. Section 2 of the statute, 9 U.S.C. § 2 (1976), creates a substantive federal right. It states that arbitration agreements in maritime and interstate contracts "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." The courts have almost universally held that this provision creates a substantive right that is equally enforceable in federal and state courts.[6]

In contrast, Sections 3-13 of the Federal Arbitration Act, 9 U.S.C. §§ 3-13, largely establish *procedural* rules to be followed in judicial actions for the enforcement of arbitration agreements. In contrast to Section 2, most of these provisions are, by their terms, applicable only to federal courts, so that when proceedings to enforce an arbitration agreement are brought in a state court, that court may apply its own procedural rules. (*See* authorities cited in appellees' Motion to Dismiss at 11-12.) This is simply an application of the general principle that states are free to apply their own court rules in cases arising under federal law, provided that such application does not impair the federal right.

The cases cited in appellees' Motion to Dismiss recognize the distinction between the substantive and procedural aspects of the Federal Arbitration Act. For example, in *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959), *cert. dismissed*, 364 U.S. 801 (1960), which appellees cite for the proposition that the Act only applies in federal courts (Motion to Dismiss at 12), the court of appeals stated:

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[6] *See, e.g., Merrill Lynch, Pierce, Fenner & Smith* v. *Haydu*, 675 F.2d 1169, 1173 (11th Cir. 1982). *See also* cases cited at J.S. App. 32a-37a.

> To be sure much of the Act is purely procedural in character and is intended to be applicable only in the federal courts. But Section 2 declaring that arbitration agreements affecting commerce or maritime affairs are "valid, irrevocable, and enforceable" goes beyond this point and must mean that arbitration agreements of this character, previously held by state law to be invalid, revocable or unenforceable are now made "valid, irrevocable, and enforceable." *This is a declaration of national law equally applicable in state or federal courts.*[7]

The decision of the California Supreme Court in the case at bar was not simply a procedural ruling governing the manner in which the trial court would conduct *its* proceedings relating to enforcement of the arbitration agreement. Rather, the decision seeks to govern the manner in which the arbitration itself will proceed and seeks to create an ongoing, intimate role for the judiciary in supervising any class action arbitration. For the reasons noted in the Jurisdictional Statement, the California court's ruling would have a serious, *substantive* impact on arbitration by converting a speedy, informal, inexpensive, nonjudicial mechanism into one that would be precisely the opposite.

This Court has previously rejected the contention that arbitration is a mere "procedural" device. In *Bernhardt* v. *Polygraphic Co. of America*, 350 U.S. 198, 202-05 (1956), the Court explicitly ruled that the procedures used in arbitration can affect the outcome of a case and are thus substantive in nature. Moreover, if this Court were

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[7] 271 F.2d at 407 (emphasis supplied). Chief Justice Burger was a member of the court of appeals' panel in *Lawrence*.

Appellees mistakenly suggest in their Motion to Dismiss that this Court held in *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), that the Federal Arbitration Act does not apply in state courts. (Motion to Dismiss at 11-12.) In fact, *Prima Paint* was a *federal* court case, and the Court did not even address the question whether the Act applies in state courts.

to accept appellees' contention that the Federal Arbitration Act is inapplicable in state courts, it would mean that a party's right to a meaningful arbitration under the Federal Arbitration Act would depend upon the forum in which proceedings were brought to enforce the arbitration agreement. In view of the fact that the Federal Arbitration Act was intended to create a uniform, national policy favoring quick and informal arbitration of disputes in interstate commerce, it is important for this Court to review and overturn the decision of the California Supreme Court.

2. *The California Legislature Cannot Create "Exceptions" to the Federal Arbitration Act*

Most of appellees' contentions concerning the power of the states to preempt the Federal Arbitration Act are addressed in the Jurisdictional Statement. However, we briefly note the following:

(a) This Court clearly has appellate jurisdiction to review the validity of the anti-arbitration policy of the California Franchise Investment Law as applied to interstate agreements. Appellees do not contend that 28 U.S.C. § 1257(2) is inapplicable to this issue and do not contend that the California Supreme Court's decision with respect to it is nonfinal.

(b) Appellees have not offered any principle to restrict the reach of their proposal to permit state legislatures to create "exceptions" to the Federal Arbitration Act. They only argue that individual state courts have in the past generally engaged in a "responsible" weighing process, balancing the policy of a local anti-arbitration statute against the contrary policy of the Federal Arbitration Act. (Motion to Dismiss at 18. *See also id.* at 14-25.) This provides no meaningful protection against erosion of the important federal policies embodied in the federal statute and, as in the present case, allows individual state courts to deprive persons of federally created and protected rights.

(c) Subsequent to the filing of Southland's Jurisdictional Statement, another court has rejected the proposition that a party can avoid arbitration by suing under a state regulatory statute. In *Klein Sleep Products, Inc.* v. *Hillside Bedding Co.*, BUS. FRANCH. GUIDE (CCH) ¶ 7886 (S.D.N.Y. 1982), plaintiff sued under the New York Franchise Sales Act and argued that claims under that law were nonarbitrable. The court held that since the case involved an interstate contract, it was obligated to enforce the arbitration agreement "regardless of state regulatory policies." *Id.* at p. 13,336.

For the foregoing reasons, appellants The Southland Corporation, *et al.*, respectfully request that appellees' Motion to Dismiss be denied.

Respectfully submitted,

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